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In the Supreme Court of the United States

OCTOBER TERM, 1936

W. A. THOMAS, COLLECTOR OF INTERNAL REVENUE,
PETITIONER

v.

J. J. PERKINS ET AL.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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The Solicitor General, on behalf of W. A. Thomas, Collector of Internal Revenue for the Second District of Texas, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered in the above-entitled cause December 18, 1936, sustaining in part and reversing in part a judgment of the United States District Court for the Northern District of Texas.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals [1] is reported at 86 F. (2d) 954. The opinion of the

[1] There were two transcripts of record before the Circuit Court of Appeals, one in No. 8172 and one in No. 8219. Record references are to the record in No. 8172.

District Court (R. 23–30) is reported at 15 F. Supp. 356.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 18, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

By virtue of a contract of assignment, the taxpayers owned an undivided fractional interest in an oil and gas lease, and in addition to a cash payment made at the time of the assignment, were obligated to pay to the assignors a further sum as oil payments if and when a certain amount of oil were produced from the property. Should the taxpayers' gross income include that part of the proceeds from the sale of the oil which was paid to the assignors of the lease as oil payments under the contract?

STATUTES INVOLVED

The statutes involved will be found in the Appendix, *infra*, p. 7.

STATEMENT

The petition of the taxpayers, who are husband and wife, filed in the District Court, seeks to recover a portion of the income tax paid by them for the year 1933 upon their community income. (R. 6–14.)

J. J. Perkins, in association with W. J. Green and Faith Oil Corporation, was interested in certain oil and gas properties located in East Texas. (R. 32.) The interest of Perkins in the property here concerned was at all times involved herein an undivided three-eighths part of the joint interest. (R. 32–33.)

Among the properties operated by these parties was a property covered by a lease which may, for convenience, be called the Hammonds and Branson lease. (R. 33.) On July 24, 1931, the Hammonds and Branson lease was assigned to Faith Oil Corporation, which acted for itself, Perkins, and Green. The pertinent portions of this contract of assignment are set out in the record (pp. 33–36). The contract recited a consideration of $10 cash paid and the further sum of $395,000 to be paid out of one-fourth of the oil produced until that amount was paid in full to the assignors by the purchasers of the oil. This oil payment was to be made only if, as and when sufficient oil was produced, and it was stated that the payment should not constitute a personal obligation of the assignees.

At the time of these contracts, there were no producing wells upon the property in question. (R. 33.) From the considerable subsequent oil production on the Branson and Hammonds property, about one-half of the oil payment of $395,000 has already been paid. The balance will be paid within two and one-half years. (R. 77.)

As the oil was produced from the property here concerned, it was run into tanks, and division orders were executed to the pipe line companies, providing that the payment of the purchase price for the oil should be made directly to the operators, the assignors, and the lessors, respectively, in accordance with their contractual rights. (R. 50.)

In their income tax returns for 1933, the taxpayers did not include the oil payments made to Branson and Hammonds. The Commissioner of Internal Revenue assessed deficiencies based upon the inclusion of the oil payments in the taxpayers' gross income. (R. 77.) The taxpayers were allowed depletion on this addition to their gross income. (R. 138–139.) After payment of the assessments, the taxpayers filed claims for refund of the tax computed upon the inclusion of the oil payments to Branson and Hammonds within the gross income of the taxpayers. The claims for refund were rejected by the Commissioner. (R. 14.)

The taxpayers have admitted that if it is held that the oil payments should not be included in their gross income, the depletion deduction allowed to them must be reduced.

The District Court held that the amount of these oil payments under the Hammonds and Branson assignment should be included within the gross income of the taxpayers. (R. 24–30.) The Circuit Court of Appeals in reversing the judgment held

that the amount of the oil payments should be excluded from the taxpayers' income.

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in holding that the amount of the oil payments made by the taxpayers to the assignors of the Branson and Hammonds lease should be excluded from the gross income of the taxpayers.

REASONS FOR GRANTING THE WRIT

1. The decision of the Circuit Court of Appeals in this case is squarely in conflict with the decision of the Circuit Court of Appeals for the Eighth Circuit in *Comar Oil Co.* v. *Burnet*, 64 F. (2d) 965, certiorari denied, 290 U. S. 652. The contracts of assignment in that case were substantially identical with the instant contract. The court there held that the title to all of the oil in place passed under the assignments, and that the amount of the oil payments was to be included within the gross income of the assignees. The payments were to be treated as capital expenditures, not deductible from gross income.

The District Court relied upon *Comar Oil Co.* v. *Burnet, supra*, and also cited *Pugh* v. *Commissioner*, 49 F. (2d) 76 (C. C. A. 5th), certiorari denied, 284 U. S. 642, and *Standley* v. *Graham Production Co.*, 83 F. (2d) 489 (C. C. A. 5th). In its opinion, the Circuit Court of Appeals expressly

declined to follow the *Comar* case. Likewise, its own reasoning in the *Pugh* case was rejected on the asserted authority of *Palmer* v. *Bender*, 287 U. S. 551. While the *Pugh* case may have been overruled in principle by *Palmer* v. *Bender*, *supra*, in so far as the question of depletion was involved, we submit that it still declares valid law as to the questions of title and the construction of the contracts.

2. This question as to the oil payments is highly important because it is a common practice in oil and gas contracts to provide for payment in that manner. A large number of cases involving this question are now pending before the District Courts and the Board of Tax Appeals. The District Court in its opinion visualized the economic effect of a decision adverse to the Government.

CONCLUSION

It is respectfully submitted that a writ of certiorari should be granted because of the clear conflict between decisions of two Circuit Courts of Appeals and because of the manifest importance of the question presented.

STANLEY REED,
Solicitor General.

MARCH 1937.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, or whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(l) DEPLETION.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * * In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *

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